IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. 877

WERT T. REED AND F. F. DOLLERT
Petitioners

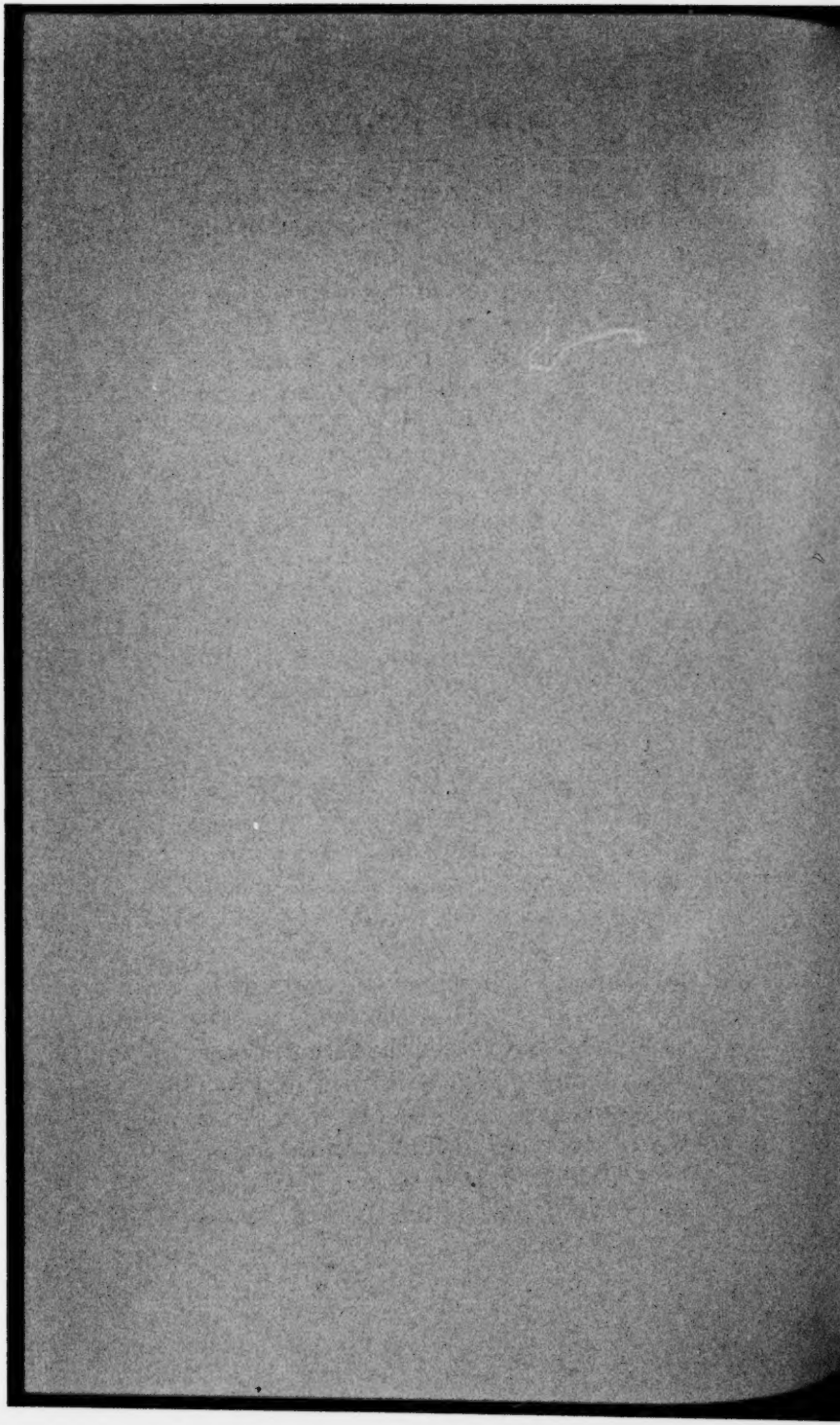
v.

HOUSTON OIL COMPANY OF TEXAS, ET AL.
Respondents

REPLY BRIEF OF PETITIONERS TO THE BRIEF OF RESPONDENTS, HOUSTON OIL COMPANY AND HOUSTON PIPELINE COMPANY

ARTHUR H. BARTHLE,
Austin, Texas
W. B. RUBIN,
Attorneys for Petitioners
Milwaukee, Wisconsin

FORM FOUNDATION—AUSTIN



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To the Honorable Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Inasmuch as respondents, Houston Oil Company and Houston Pipe Line Company, in their brief just filed with this Court, have raised and argued as de-

fenses res judicata, estoppel, laches, stale demand, and the statutes of limitation, questions as to which the opinion of the Circuit Court of Appeals of the Fifth Circuit is silent, it becomes necessary for petitioners to ask leave of this Court to file their reply to those contentions of said two respondents.

The silence of the opinion of the Circuit Court of Appeals on the defenses pleaded by respondents, the Houston Oil Company and the Houston Pipe Line Company, apparently is taken by said two respondents as sustaining their before mentioned special defenses in full and with the same effect as though the Circuit Court of Appeals had in its opinion especially sustained each and every one of these defenses. Such clearly being the assumption of said two respondents, then

I. The Decision of the Circuit Court of Appeals in Sustaining the United States District Court Judgment is in Conflict.

(a) With the Decision of this Court as to a Federal Question, when the Circuit Court held, namely, that a Dismissal of a Stockholders' Class Action in Vacation Time, With "Prejudice," Without Notice by a State Court, Does Not Violate the Due Process Clause of the Fourteenth Amendment of the United States Constitution.

The Circuit Court of Appeals of the Fifth Circuit has decided a Federal question in affirming the de-

cision of the Federal District Court which, in turn, approved the action of a state district court in dismissing a stockholder's class action in vacation time without previously giving or even attempting to give notice to about 400 stockholders of the Pratt-Hewit Corp. that the case was to be dismissed with *prejudice*, thereby depriving the stockholders without the due process of law of their right to prosecute said action in behalf of their corporation as guaranteed to them by the Fifth and Fourteenth Amendments of the Constitution of the United States, in a way deemed untenable and in conflict with the recent decision of this Court in the case of *Hansberry* v. *Lee*, 311 U. S. 32, 61 S. Ct. 115.

In brief, the state case was one in which W. E. Hewit, one of the promoters of the Pratt-Hewit Corporation venture and a stockholder of that corporation, filed suit in behalf of himself and other stockholders against the Pratt-Hewit Corporation, Houston Oil Company, Thomas H. Pratt, individually, and all of the other directors and officials of the Pratt-Hewit Corporation, on September 28, 1927, in the District Court of Refugio County, Texas, to cancel the September 28, 1925 contract on various grounds, as set out in paragraphs 18-25 inclusive and plaintiffs' Second Amended Complaint (Tr. R. 326-332) however, not for the fraud set out in the present cause of action. The evidence of this fraud was concealed in the private files of the Pratt-Hewit Corporation and of Thomas H. Pratt and was not discovered until the spring of 1939, as has already been shown in the petitioner's application for certiorari.

F. F. Dollert intervened in that state court case by his own attorney, a Mr. Booth of San Antonio, Texas. Five or six other stockholders also intervened in this case which went to the Supreme Court of Texas on a technical point of procedure.

On January 26, 1937, during vacation time, upon the request of plaintiff Hewit and intervenors, except F. F. Dollert, and also upon the written request of the Houston Oil Company and the officials of the Pratt-Hewit Corporation, the case "was dismissed with prejudice at the cost of the defendants." The judge of that court, the Honorable J. P. Poole, had disqualified himself from sitting in the case. He was obliged to qualify himself before the case could be dismissed by him. This proceeding, including the dismissal of the action, is to be found on pages 223-228 of the Transcript of Record. No notice of any kind that the case was to be taken up in vacation time and that it was to be "dismissed" with prejudice" was sent out to a single stockholder. Most of the 400 stockholders were living in Wisconsin. No testimony was taken when the case was dismissed. Dr. Dollert, who lived and practised his profession in Milwaukee, Wisconsin, testified that he had no notice that the case was to be dismissed and knew nothing about the dismissal until about 18 months thereafter. (Tr. R. 804) By the time this case was tried in March, 1941, Mr. Booth, Dollert's attorney had died. No evidence was offered by the defendants that notice of contemplated dismissal of the case had been given him.

Mr. Reed testified that he knew nothing about the bringing of this suit until this case was brought. (Tr. R. 812).

When this state court case was dismissed on January 26, 1927, it is undisputed that the shareholders of the Pratt-Hewit Corporation except those who appeared on that day and by their attorney signed the application to have the case dismissed with prejudice, were simply ignored. Nothing was done or attempted to be done to protect their rights.

The right of representation by the plaintiff in a derivative stockholders' suit, that is, in a true class action, empowers the plaintiff, if acting in good faith and not disqualified because of conflicting interest or otherwise and the shareholder himself does not intervene, with the right to prosecute the suit to judgment, but it does not carry an implied unqualified right to dismiss with prejudice or compromise the action without giving full and adequate notice of his proposal to do so, giving necessary conditions involved in the compromise or reasons for dismissal and making proof of such efforts to apprise the absent shareholders thereof to the satisfaction of the Court that said shareholders have had adequate notice to satisfy the requirements of "due process of law" of the Fourteenth Amendment of the United States Constitution so as to permit the judge to enter the order of "dismissal with prejudice."

The absentee shareholder has a vested right as

to which the plaintiff stockholder has no right to do as he pleases. Certainly, the plaintiff stockholder cannot enter into any arrangement that would divest a distant stockholder of his property right without full and adequate notice first being given to such absentee stockholder. If that is not true and the law in the case, then any compromise or settlement made, being binding upon the absentee stockholder, would deprive him of the due process of law guaranteed to him by the Fifth and Fourteenth Amendments of the Constitution of the United States. To permit such practice would open the door to the greatest of frauds.

The Constitution of the United States does not compel the states to adopt any particular phraseology in writing their rules of procedure to be followed by their courts in order that the requirements of the Fourteenth Amendment "due process of law" clause may be met, but it does require the states to adopt and put in force *some kind* of procedure or rules to be followed by the courts sufficient to satisfy the constitutional rights guaranteed every citizen of the United States by the Fourteenth Amendment as expressed in its "due process of law" clause. *Hansberry* v. *Lee*, 311 U. S. 32, 61 S. Ct. 115.

No procedure of any kind was followed or attempted to be followed by which the rights of the absent shareholders could have been protected. The judgment entered, therefore, on the face of the record is void as to the shareholders of the Pratt-Hewit Corporation, including Dollert and Reed, except as

to those who were present by themselves personally or by their attorneys.

> "When the judgment of a state court, ascribing to the judgment of another court the binding force and effect of res judicata, is challenged for want of due process it becomes the duty of this Court to examine the course of procedure in both litigations to ascertain whether the litigant whose rights have thus been adjudicated has been afforded such notice and opportunity to be heard as are requisite to the due process which the Constitution prescribes. Western Life Indemnity Co. v. Rupp, 235, U. S. 261, 273." Hansberry v. Lee (Supra).

(b) **With the Decision of this Court as to a Federal Question, when the Circuit Court held, namely, that in a Stockholders' Class Action where the Suit is Dismissed with Prejudice in Vacation Time, the Corporation, although Nominally a Defendant, is the Real Plaintiff, is Attempted to be Represented by an Officer, also a Defendant, and his Private Attorney, Does Not Deprive the Corporation of Due Process of Law as Guaranteed to It under the 14th Amendment of the U. S. Constitution.**

The Circuit Court of Appeals of the Fifth Circuit has decided a Federal question in affirming the decision of a Federal District Court, which, in turn, approved the action of a state district court in *dismissing with prejudice* a stockholders' class action when the corporation in whose behalf the suit was

brought by the stockholders was not represented by its own attorney but was attempted to be represented by an officer of the corporation, also a defendant, and by his private attorney, thereby depriving said corporation, although nominally a defendant, in fact, a plaintiff, without the due process of law, of the right to have the suit prosecuted in its behalf to judgment, or if the case is to be settled or dismissed, to have the advice and aid and counsel of its own attorney, as guaranteed to such corporation by the Fifth and the Fourteenth Amendments of the Constitution of the United States, in a way deemed untenable and in conflict with Hansberry v. Lee (Supra) and other decisions of this Court.

In the foregoing suit in the state court, of Hewit et al v. Pratt-Hewit Corporation, Houston Oil Company, and Thomas H. Pratt et al, while the Pratt-Hewit Oil Corporation was nominally a defendant, nevertheless, it was the real plaintiff. Thomas H. Pratt and each one of the officials and directors were defendants. A dismissal of the suit would be highly beneficial to the defendants Thomas H. Pratt and the directors of the Pratt-Hewit Corporation, but greatly prejudicial to the Pratt-Hewit Corporation itself. That presented a direct conflict of interest with duty between directors and officials and their corporation, which disqualified them from consenting to a dismissal of the suit with prejudice on behalf of the Pratt-Hewit Corporation, in fact, wholly disqualified them from advising or acting in behalf of the Pratt-Hewit Corporation in this suit. The answers of Pratt and of the Pratt-Hewit Corpora-

tion were each verified by Pratt and were signed by Attorneys Crain and Vandenberge.

Attorneys Crain and Vandenberge were the private attorneys for Thomas H. Pratt and the other directors and officials of the Pratt-Hewit Corporation and also represented the Pratt-Hewit Corporation during this entire litigation and at the time the case was dismissed. (Tr. R. 225-228). These attorneys likewise were disqualified from representing the Pratt-Hewit Corporation. Their signature to the request for and consent to entering judgment of dismissal with prejudice is a nullity. The Pratt-Hewit Corporation is not bound by that judgment. Being a nullity, it is not res judicata at least so far as the Pratt-Hewit Corporation and its stockholders including Dollert and Reed, are concerned.

In the case of *Blaustein* v. *Pan Am. Pet. & Trnspt. Co.*, 21 N.Y.S. (2d) 651, page 729, the Court held that the attorney for a parent corporation was disqualified from rendering an opinion for its subsidiary in a matter involving conflict between the parent and subsidiary corporation.

(c) With the Decisions of the Texas Courts as to Local Law, when the Circuit Court held, namely, that a Burden of Proof as to whether the Decision of a State Court was Res Judicata upon the Plaintiffs Reed and Dollert and Not upon the Defendants in the United States District Court.

The decision of the Circuit Court of Appeals in affirming the decision of the United States District Court which held that the burden of proof as to whether the decision of the State District Court in the former case of Hewit et al v. Pratt-Hewit Corporation et al was res judicata was upon plaintiffs Reed and Dollert and not upon the Houston Oil Company and the Houston Pipe Line Company who plead res judicata, is a decision of local law in a way probably in conflict with the decisions of the Supreme Court and other courts of the State of Texas.

In the motion of the Houston Oil Company to dismiss plaintiffs' second amended complaint, among other exhibits attached, there was Exhibit C which was a copy of the record in the case of Hewit et al v. Pratt-Hewit Corporation et al, Case No. 795, in the District Court of Refugio County, Texas, and it is to be found on pages 186-228 of the Transcript of Record. On pages 223-228 is to be found the request for dismissing the case during vacation time and the judgment of dismissal with prejudice which, as we have just seen, on its own face is void, at least as to the Pratt-Hewit Oil Corporation, petitioners Reed and Dollert and the stockholders of the Pratt-Hewit Corporation, except those who were present in person or by their attorneys. This record of this judgment was pleaded by the Houston Oil Company and the Houston Pipe Line Company. They are therefore bound by what the face of this judgment roll indisputably shows.

The burden of proof that a former judgment, according to the decision of Texas courts, and probably in all jurisdictions, is upon him who pleads such a defense.

> "As a general rule, a person claiming that a former judgment is res judicata has the burden of proving that fact. He must show that the judgment was a final and valid adjudication, rendered on the merits of the controversy, between him and his adversary. If the judgment was pleaded in bar, he must show that it definitely disposed of the claim or demand that forms the subject matter of the suit; and if it was pleaded as an estoppel, he must show that it necessarily decided the issue as to which he claims it is res judicata." 26 Tex. Jur. Sec. 510, p. 340. See also Pye, et al v. Wyatt, 151 S. W. 1086, and many other Texas cases cited.

The Houston Oil Company and the Houston Pipe Line Company have not only failed to make good the burden of proof which is on them but that which they did offer as evidence in the question of res judicata clearly shows that the judgment in the case of Hewit et al v. Pratt-Hewit Corporation et al in the State Court is not res judicata in the instant case.

Reed, Dollert, and the Pratt-Hewit Corporation and its stockholders being strangers to the judgment, could assail the same on any ground which a party thereto could urge on a direct attack.

> "It is a familiar rule that in the case of a col-

lateral attack upon a judgment by a party thereto every reasonable presumption is indulged to support the judgment. Treadway v. Eastburn, 57 Tex. 211; Hardy v. Beaty, 84 Tex. 567, 19 S. W. 778, 31 Am. St. Rep. 80. But it is equally as well settled that that rule has no application when the judgment is invoked against one not a party to the suit in which it was rendered, and that such a stranger may attack it on any ground which can be urged in a direct attack. Scales v. Wren, 103 Tex. 304, 127 S. W. 164; Sanger Bros. v. Trammel & Co., 66 Tex. 361, 1 S. W. 378; Blankenship v. Wartelsky, 6 S. W. 140; Bonner v. Ogilvie, 24 Tex. Civ. App. 237, 58 S. W. 1027." Turner v. Maury, (Civ. App.) 224 S. W. 255. Reversed on other points (Com. App.) 244 S. W. 809.

"But whenever a judgment or decree is procured through the fraud of either of the parties, or by the collusion of both, for the purpose of defrauding some third person, he may escape from the injury thus attempted by showing, even in a collateral proceeding, the fraud or collusion by which the judgment or decree was obtained." Freeman on Judgments, Fifth Edition, 632.

We have already seen in the petition for certiorari that the affirmance by the Circuit Court of Appeals of the decision of the United States District Court in holding that the September 28, 1925 contract, on its face, is legal, is directly in conflict with the statutes and the decisions of the Texas courts. This is discussed and authorities cited in a petition of certiorari as to the unlawful delegation of the managerial powers of the Pratt-Hewit Corporation on

pages 42 to 48, as to Usury on pages 48-53, and on Monopoly and Anti-Trust Laws on pages 52-56.

The September 28, 1925 contract, inasmuch as it contains a number of provisions which directly violate the laws of Texas and which are in conflict with the court decisions of that state, on its face is void. It, therefore, never was a contract. It never has had any existence. "There is no power which can breathe life or validity into it." *Myers* v. *Walker*, 276 S. W., 305, 307. (Tex. Civ. App.)

> "A void judgment has been termed mere waste paper, an absolute nullity; and all acts performed under it are nullities. Again, it has been said to be in law no judgment at all, having no force or effect, conferring no rights, and binding nobody. It is good nowhere and bad everywhere, neither lapse of time nor judicial action can impart validity. It is not susceptible of ratification or confirmation, and its invalidity may not be waived." 25 Tex. Jur. Sec. 254, p. 693.

For further Texas authorities on this question see pages 76 and 77 of petitioner's application for certiorari.

(d) With the Decision of the Texas Courts as to Local Law, when the Circuit Court held, namely, that Plaintiffs Reed and Dollert "Were Estopped to Deny such Contract (September 28, 1925) because in a Final Agreed Judgment Entered in 1938 in still another Suit Filed in 1933 in a State Court They had Recognized Such

Contract," when Plaintiffs had No Knowledge of the Fraud Perpetrated in the Making of the September 28, 1925 Contract, which is Void on its Face.

The decision of the Circuit Court of Appeals, in affirming the decision of the United States District Court, which held that plaintiffs Reed and Dollert "were estopped to deny such contract (September 28, 1925) because in a final agreed judgment entered in 1938 in still another suit filed in 1933 in a state court they had recognized such contract" (Respondents Houston Oil Company et al, brief, page 3), even though plaintiffs had no knowledge of the fraud and the contract itself is void on its face, is a decision of local law in a way probably in conflict with the decisions of the Supreme Court and other courts of Texas.

In the case filed in the state court in 1933 the validity of the September 28, 1925 contract was not in issue. In this case the Houston Oil Company and the Pratt-Hewit Corporation and a great many other parties were sued on an entirely different question. Furthermore, this suit was disposed of in April, 1938, a year before the first evidence of fraud as detailed in the 18 Overt Acts in the petition for certiorari, was discovered. Furthermore, "in order to assert an estoppel by conduct, the position of the parties must have been altered to the injury of the party asserting the right of estoppel." *Walker* v. *Millican*, 150 Ky. 12; 150 S. W. 71. See also 31 C.J.S. 275. "The doctrine of estoppel is available only for protec-

tion and cannot be used as a weapon of assault." *Dickerson* v. *Colgrove*, 100 U. S. 578, 25 L. Ed. 618.

The Houston Oil Company et al neither plead injury nor did they ever offer any evidence showing damages by the conduct now claimed as an estoppel.

When a contract of a corporation is prohibited by statute or is against public policy or is beyond the powers conferred upon the corporation by the legislature, neither the corporation nor the shareholder suing in its behalf is estopped to assert its invalidity.

> "The contract was an executory one, and the rule is thoroughly established that when money has been paid on an illegal contract it can be recovered as long as the contract remains executory. Levy v. Crawford, 5 Tex. Civ. App. 293, 23 S. W. 104; McCall v. Whaley, 52 Tex. Civ. App. 646, 115 S. W. 658. Appellant is not seeking to enforce an illegal contract, but he wants the money back obtained from him through a fraudulent and void contract. He seeks to disaffirm and destroy the illegal contract and have both parties placed in the same position they occupied before the void contract was made. Federal Life Ins. Co. v. Hoskins, 185 S. W. 607. If the contract for the policy was illegal, appellee will not be permitted to profit by it, but will be forced to return the money and leave the parties as they were when the contract was made." Trammel v. San Antonio Life Ins. Co. (Tex. Civ. App.) 209 S. W. 786, 789.

In *Sherman & Ellis Inc.*, v. *Indiana Mutual Casualty Co.*, (CCA, 7) 41 2d 588, the Court held Void an

agreement made between Sherman and Ellis, Inc., and the Indiana Mutual Casualty Company in which the latter conferred the management of its affairs upon Sherman and Ellis, Inc., for a period of 20 years.

The Court said: (Evans, Cir. Judge).

> "Estoppel. Appellant contends that, even though the contract be void, the Casualty Company is estopped to assert such invalidity. Little need be said respecting this contention. The law is clear, we think, that a corporation which makes a contract void because the corporation making it was without authority so to do, because against public policy, is never estopped to assert its invalidity. The reason for its invalidity was known to both parties when the contract was executed. 7 R. C. L. 530; Central Lafayette Railroad Co., 50 Ind. 112; Central Transportation Co. v. Pullman Car Co., 139 U. S. 24, 59, 60; 11 S. Ct. 478, 35 L. Ed. 55."

When a contract of a corporation is beyond the powers conferred upon it by existing laws or is prohibited by statute or is contrary to public policy, then "to maintain such actions is not to affirm but to disaffirm the unlawful contract." *Central Transportation Co.* v. *Pullman Car Co.*, 139 U. S. 24, 59, 60, 11 S. Ct. 478, 35 L. Ed. 55.

In the case at bar, plaintiffs Reed and Dollert, in behalf of the Pratt-Hewit Corporation, are not claiming any rights or damages through the illegal contract but are suing to cancel the contract and

have the property restored to the Pratt-Hewit Corporation which it owned in September 28, 1925, the date of the unlawful contract, together with the oil and gas which has been taken out from underneath the leases and which was in place under said leases on September 28, 1925.

"U. S. Md. 1822. One may not claim a right springing out of his own wrong. The Arrogante Barcelones, 20 U. S. 496, 7 Wheat 496, 5 L. Ed. 507." Fed. Dig. Vol. 29, p. 651.

Neither estoppel, res judicata, laches, limitations, waiver or consent can create a legal right out of that which a statute, public policy or public law says is nothing.

> "C.C.A. Ga. 1938. One guilty of fraud cannot urge estoppel against the other party to the contract for the purpose of making his fraud effective. New York Life Ins. Co. v. Odom, 93 F. (2d) 641, certiorari denied. Odom v. New York Life Ins. Co. 58 S. Ct. 948, 304 U. S. 566, 82 L. Ed. 1532." Fed. Dig. Vol. 29, p. 651.

(e) With the Decision of the Texas Courts as to Local Law, when the Circuit Court held, namely, that Plaintiffs Reed and Dollert Owed a Duty to the Defendants in Failing to have Discovered the Fraud Complained of and were, therefore, Guilty of Laches.

The decision of the Circuit Court of Appeals in affirming the decision of the United States District

Court, which is to the effect that the plaintiffs, Reed and Dollert, owed a duty to the defendants, that of discovering the fraud (the bribing instruments) of which they now complained in their complaint, namely, Exhibits 9-13 inclusive, (Tr. R. 911-944) Exhibits 37 (Tr. R. 973) and the four loans with which the Houston Oil Company accommodated Pratt, is a decision of local law in a way probably in conflict with the Supreme Court and other courts of Texas.

The following is the Court's Finding of Fact No. 12, Tr. R. 514 and 515.

> "Now the plaintiff Reed at the time he acquired his stock by assignment from Elsie Essman on May 11, 1927, knew, or he should have known, of the existence of this suit. At least he should have known about it during the year of 1927 when it was brought. He knew of it during subsequent years or he could have known of it by the exercise of any degree of diligence whatever, and he knew that it was a suit making general charges of fraud and mismanagement on the part of Pratt, and especially attacking the execution of the contract of September 28, 1925.

The Court's Finding of Fact No. 13, Tr. R. 515, reads as follows:

> "Neither the plaintiff Reed nor the intervener Dollert took a single step, so far as the record shows, to determine the truth of the averments of fraud that were made or to locate the evidence now tendered in support of the charge of fraud.

> The evidence that they now assert to show that there was a purchase of Pratt's official discretion, by the exercise of reasonable diligence, by searching the files of Court cases pending or disposed of, and by the taking of depositions, could have been obtained long before the filing of this suit, and the plaintiff Reed and intervener Dollert could have learned of the existence of the documents upon which they now rely as evidence of fraud. So far as the record before me shows, there was no attempt made to mislead or deceive them by anybody. . . . "

Conclusions of Law, No. 6, (Tr. R. 519) says:

> "Since both the plaintiff and the intervener knew of the pendency of the suit in the State District Court of Refugio County and knew of the general charges made in the various letters to the stockholders to the effect that the contract of September 28, 1925 was in fraud of the rights of the stockholders of the corporation, and since Dollert, the intervener, was a party to that suit, and since both intervener and plaintiff could have known or could have learned of the existence of the very evidence now relied upon by them to show fraud, they have been guilty of laches and of such delay in the bringing of this suit, that they are not entitled to maintain it now."

The foregoing Findings of Fact and Conclusions of Law are to the effect that if rumors of fraud had come to a stockholder in Wisconsin, in order to prevent the stockholder's right of action being barred by laches, it was such stockholder's duty to have come to Texas, not only to examine the record in the

county clerk's office in Refugio County in which all deeds and mortgages and oil and gas leases are recorded, but also the Court says "by searching the files of court cases pending or disposed of and by taking depositions, could have been obtained long before the filing of this suit, and the plaintiff, Reed, and intervener, Dollert, *could have learned of the existence of the documents* upon which they now rely as evidence of fraud." That means, of course, that all State and Federal courts in Refugio and adjacent counties where litigation might be pending or had been disposed of and in which some evidence might have been discovered of fraud committed by Pratt and other officials of the Pratt-Hewit Corporation, the records and the testimony must be examined. But the testimony in every case is not transcribed, or if it had been, would be in the possession of the party who paid for having it transcribed.

The Court said, "The evidence that they (plaintiff Reed and intervener Dollert) now assert to show (Exhibits 9-13, 37, and the loans) . . . by the taking of depositions, could have been obtained long before the filing of this suit, and the plaintiffs Reed and Dollert could have learned of the existence of the documents upon which they now rely as evidence of fraud." But depositions cannot be taken until suit has been filed unless it is for the purpose of perpetuating the testimony of some important witness who may die before litigation can be commenced.

Until a complaint is filed and issues joined, just what right of examination and just what the exam-

ination would be about would be unknown. With no suit commenced, with what authority could anyone be subpoenaed to appear before an officer who had the right to take testimony and compel such party to give evidence? Is not the party who is to be examined entitled to know what it is all about? Train fare from Wisconsin to Texas and taking depositions cost time and money. Supposing the stockholder has only invested two or three hundred dollars in the venture.

Of the bribery instruments, Exhibits 9-13, and 37, only one to this day has ever been put of record. That is the lease which F. B. Rooke and wife gave to their son, A. D. Rooke, on a 200 acre tract. That instrument, recorded, gives no information as to what transpired thereafter. Standing by itself, it is perfectly harmless. Assume that there was a rumor of fraud. Just how could the suspecting stockholders have discovered the loans which the Houston Oil Company extended to Pratt with no records anywhere, except in the books of account of the Houston Oil Company?

The term "fraud" is a conclusion of law derived from acts committed. Fraud may be committed in hundreds of different ways. It gives no indication whatsoever as to what the acts were which constitute fraud. Just where would one look to find what those facts were?

The Finding of Fact shows "so far as the record before me shows, there was no attempt made to mis-

lead or deceive them by anybody." Then how did it happen that all three, the Houston Oil Company, Pratt and A. D. Rooke, to this day, failed to put their instruments of record? Why did Pratt keep all of this information away from the stockholders of the corporation during all his lifetime?

(1) The Victim of a Fraud Owes No duty to Him Who Perpetrated it.

"Whatever may be the rule with reference to the use of diligence to discover fraud, we hold in this instance that owing to the relation of parties, as above set forth, plaintiffs were under no duty to exercise diligence to discover the over charges (even if they could have reasonably done so) until they came into possession of facts sufficient to cause them to distrust defendants and to put an ordinary prudent person on inquiry." El Paso Electric Co. v. Reynolds Holding Co., 100 S. W. (2d) 97, 102 (Tex. Com. App.)

"Section 73, p. 162 N. 2 Fiduciary Relationship Excuses Inquiry. Wichita Royalty Co. v. City Nat. Bank (Sup.) 89 S. W. (2d) 394, 405, 406, modifying 74 S. W. (2d) 661, rehearing denied 93 S. W. (2d) 143." Tex. Jur. 1937 Supplement p. 1831.

" . . . one who is guilty of an affirmative fraulent misrepresentation of a fact cannot urge that the defrauded party could have discovered the truth had he diligently made investigation. This rule has been followed by the court in subsequent cases (see Buchanan v. Burnet, 102 Tex. 492, 495, 119 S. W. 1141, 132 Am. St. Rep. 900)

and would appear to be applicable here. Whether so or not, however, we think the relationships existing and the facts and circumstances above stated were sufficient to excuse the failure of Maxwell sooner to investigate and discover the true facts upon which his suit was predicated." Trinity-Universal Ins. Co. v. Maxwell, 101 S. W. (2d) 606, 611.

"Failure to make inquiry which would reveal existence of fraud and so start statutes of limitation to run against defrauded party may be excused where the relationship of trust and confidence existed between the parties. This is also true where the conduct or continued representations of the guilty party are such as to lull the injured party into a sense of security or to conceal suspicious circumstances." Trinity-Universal Ins. Co. v. Maxwell (Tex. Civ. App.) 101 S. W. 606, 611, Error dismissed. Citing—20 Tex. Jur. 114, Sec. 76.

(2) The Registration in the County Clerk's Office in Texas of an Instrument Representing a Fraudulent Claim Does Not Operate as a Constructive Notice.

"The registration in the county clerk's office of a deed, by law, constructive notice of a bona fide transfer or ownership, from the date of registration; for the law has designated that office as a proper place for the registration of such transactions; but the law has made no such provision for the registration of frauds. It is true that registration is a notorious act, which in time would create a presumption of notice of a fraud, but whether such notice would be pre-

sumed in one or ten years is a question of fact to be decided by a jury." Andrews v. Smithwick, 34 Tex. 544.

"While it is true they could have gone to the deed records of the county and there discovered that no transfers to the oil company had been rendered, yet it cannot be said, as a conclusion of law, that such a discovery, standing alone, as a further conclusion of law, would have made them chargeable with knowledge of the further fact that no such transfer had been executed, and that defendant had never intended to execute one, or that the oil company had never owned any assets." Thomason v. McEntire (Tex. Civ. App.) 233 S. W. 616, affirmed 113 Tex. 220, 254 S. W. 315.

"The Supreme Court has said, however, that 'neither a registration of a deed in the county clerk's office, nor the records in the adjutant general's office, could operate as constructive notice of the fraudulent claim from the date of registration or other record.' (Andrews v. Smithwick, 34 Tex. 544). And there is authority to the effect that, with respect to the diligence of a beneficiary in discovering a trustee's fraud in failing to pay over the proceeds of a note, the registration of a release of the note was not notice to the beneficiary. Needless to say, a party will not, by reason of a failure to examine the records, be chargeable with knowledge of facts which may not be ascertained therefrom." 28 Tex. Jur. 163.

"Recording of mineral deed fraudulently represented to plaintiff as a mere lease held not to be constructive notice to plaintiff of fraud so as

to set the statute of limitation running. Straud v. Pechacek, (C.A.) 120 S. W. (2d) 626." Tex. Jur. 1939 Supp. p._____.

(3) Rumors and Suspicion are Insufficient to Charge Notice

"Circumstances which merely arouse suspicion in the mind of a reasonably prudent person are generally regarded as insufficient to charge notice" Billingsley v. Mossler Acceptance Co., 119 S. W. (2d) 196 (Tex. Civ. App.); General Motors Acceptance Corp. v. Fowler, 36 S. W. (2d) 589, 590, 46 C. J. 548.

"But it is clearly settled that 'vague and indeterminate rumor or suspicion, is quite too loose and inconvenient in practice to be admitted to be sufficient." Wethered v. Boon, 17 Tex. 143; Myers v. Crenshaw, 112 S. W. 1125 (Tex. Civ. App.).

The District Court's Findings of Fact and Conclusions of Law are to the effect, first, that the victim of a fraud owes a duty to the guilty party of using reasonable diligence in discovering the fraud, second, that a recorded fraudulent instrument is constructive notice of the fraud. That is not the law in Texas, as the foregoing cases clearly show, nor in any other states, nor in the Federal courts. If it were, then those engaged in defrauding the public could put themselves in the safety zone where they would be unmolested by the courts in selling stock or oil and gas leases to people living in distant states, just so they were careful not to sell to anyone

except small investors who could not afford making investigations. If such would be the law, then it would mean that whenever a citizen bought stock, it would be necessary for such purchaser to engage an investigator to make periodical searches of the records to make certain that those who were handling his money were not perpetrating a fraud upon him. It is evident that the question of law involved in the District Court's Findings and Conclusions of Law is one of paramount interest to the public.

The Circuit Court of Appeals said "The findings and conclusions of the District Court are free from error."

The first definite inkling as to the existence of the bribing instruments was not until March or April, 1939. Furthermore, the payoff on the royalty bribe of a 3/32 interest in the 200 acre Rooke lease has continued each month and is being paid each month since September 1, 1925. Each payment is a part of the original fraud. This has been shown in the petition for certiorari, pages 78-84.

The length of the time in which the fraud is concealed is immaterial. In the case of *Fleishhacker et al* v. *Blum et al*, 109 Fed. (2d) 543, *Blum* v. *Fleishhacker*, 21 Fed. Supp. 527, the time between the commission of the fraudulent act which consisted of Fleishhacker, president of a bank, putting himself in a position where self interest conflicted with duty, until the case was filed, was 15 years. That is about the same time that elapsed between the date of the

September 28, 1925 contract and when the complaint was filed in the instant case in February, 1941.

II. The District Court's Finding of Fact, Last Paragraph of Transcript of Record 517, which was Sustained by the Circuit Court of Appeals, that the Loans which the Houston Oil Company Extended to Thomas H. Pratt Were Used by Him for the Benefit of the Pratt-Hewit Corp. is Wholly Unsustained by the Evidence.

On page 8 of the respondents', Houston Oil Company et al, brief, it is stated "Petitioners in their complaint, alleged nothing about the loans made by the Houston Oil Company to the secretary (Thomas H. Pratt) of the Pratt-Hewit Oil Corporation, but on their appeal claimed that this was fraud in securing said contract." At the time the suit was filed and for some time thereafter plaintiff knew nothing about the four loans totaling $14,500 which had been extended to Pratt by the Houston Oil Company. This evidence was not discovered until about two months before the case went to trial when through the order of the Court the plaintiffs were permitted to examine the account books of the Houston Oil Company.

There is no evidence whatsoever in the record to support the findings of the District Court just referred to.

The testimony of Fairbrothers, the supervising accountant of the Houston Oil Company, is to be

found on pages 768-780 in the Transcript of Record. He testified definitely from the page in the Houston Oil Company's account books which recited the loans made to Thomas H. Pratt, of which there were four, that they were Pratt's and not the loans of the Pratt-Hewit Corporation, that is, the notes were signed by him personally and not as an officer of the Pratt-Hewit Corporation.

The September 28, 1925 instrument, in fact, was primarily a loan contract. (Exhibit 4, Tr. R. 876) Loans totaling nearly $100,000. were provided for in paragraphs "I," "IV," and "V." This money was not loaned on a contingency but the agreements required that the money be repaid by the Pratt-Hewit Corporation definitely. Each loan calls for the payment of interest at 6% and was secured by a mortgage lien to be given by the Pratt-Hewit Corporation.

Inasmuch as the loans extended to Thomas H. Pratt were kept on a separate page, there must have also been a separate account in the books of the Houston Oil Company where the loans called for and described in the September 28, 1925 contract were specially kept, so that there could be no confusion in the books of the Houston Oil Company as to what were the loans extended to Thomas H. Pratt personally and what were the loans extended to the Pratt-Hewit Corporation, and which Pratt signed as an official representing that corporation.

The only evidence which was offered at the trial

of the case that any of the money loaned Thomas H. Pratt was used for the benefit of the Pratt-Hewit Corporation was the first loan of $5,000. This evidence consisted of excerpts from a deposition taken by written interrogatories put to Mr. Pratt for answer in a case which was filed in the Federal Court at Victoria, Texas, on September 28, 1925, 16 years before the case at bar was tried. In this early case the Pratt-Hewit Corporation was plaintiff and Pratt himself and W. E. Hewit and O. R. Seagraves were parties defendant. This suit was brought to cancel a gas contract made April 26, 1923. Consequently, the parties and the issues are not the same in the two suits. Objections to the introduction of said affidavit were properly made but overruled. (Tr. R. 844-863).

The Pratt-Hewit Corporation was organized on April 16, 1923. On that same day, through its incorporators, it conveyed to Hewit and Pratt individually all the natural gas in place underneath the 23,000 acres of oil and gas leases which had just been conveyed to the Pratt-Hewit Corporation and which had on it two big producing natural gas wells. The consideration for this contract was that Pratt and Hewit would find a market for the gas discovered and which was being produced. In this they failed. They then conveyed this gas contract to O. R. Seagraves in 1924. Between July, 1924 and March 1, 1925, Pratt eliminated Hewit, the other promoter, as president and director of the Pratt-Hewit Corporation. Hewit was working with O. R. Seagraves of Moody and Seagraves who then owned the nat-

ural gas contract which the Houston Oil Company wanted. Pratt played with the Houston Oil Company.

Thus O. R. Seagraves and Pratt himself and Hewit, by virtue of this gas contract, stood in the way of making the September 28, 1925 contract between the Houston Oil Company and the Pratt-Hewit Oil Corporation. Consequently, on August 27, 1925, Pratt had the directors of the Pratt-Hewit Corporation pass a resolution which was also signed by Pratt as a director and again as a secretary, which stated that Thomas H. Pratt and W. E. Hewit had breached their contract with the Pratt-Hewit Corporation of April 16, 1923 and authorized Pratt and the company's president, Mr. Sharp, to institute suit in behalf of the Pratt-Hewit Corporation against Pratt himself and W. E. Hewit and O. R. Seagraves to cancel the gas contract. This is the "Overt Act" No. 7 mentioned on page 9 of the petition for certiorari.

Two days thereafter, on August 31, 1925, the Houston Oil Company secretly loaned Pratt $5,000. This Overt was Act No. 8

It was in this suit which was filed in the Federal Court at Victoria on the same date that the September 28, 1925 contract was executed, that Pratt's deposition by written interrogatories was given and from which excerpts certified by the United States District Court were offered in evidence at the close of the instant case without giving any notice what-

soever to the opposing attorneys or without submitting the original whole deposition which the attorneys for the Houston Oil Company promised and failed to do. (Tr. R. 844, 845).

> "It is to be borne in mind that depositions taken in other actions are not to be received in evidence, unless the parties are the same or in privity, and unless the issues are substantially the same. To admit evidence of such character would deprive the party against whom the deposition is offered of the right of notice, and of the right to attend and cross-examine the witness." Jones on Evidence, (2d) 851.

The last interrogatory in the deposition was No. 103. Whether there were any more is not known. Out of No. 103, the excerpt contained only about one-fourth of the questions.

Mr. Blades, the attorney for the Houston Oil Company, stated the purposes for which the deposition was to be offered, which were two:

(a) "This deposition will show that Mr. Pratt admitted back on March 30, 1936 that he did have the 3/32 interest in the 200 acre lease." (Tr. R. 845)

"Cross Interrogatory No. 15:

Do you own any oil or mineral leases on lands in Refugio County which do not appear of record?

Answer:

Yes; an undivided three-thirty-seconds in two hundred acres."

"Cross Interrogatory No. 17:

If you have answered either of the three foregoing questions affirmatively, then state what such leases are, when you acquired them, why you have not recorded them if they are not recorded, and why they were not taken in your own name if they are held for you by any other person or corporation? And in this connection, give the names of the persons who hold such oil and mineral leases for you?

Answer:

About August 1st, 1925, I leased from Clinton Heard one hundred acres, which is recorded. I did not record the three-thirty-seconds, as all parties had actual notice." (Tr. R. 849)

This is all there is in Mr. Pratt's deposition as to that 3/32 interest in the A. D. Rooke lease. Consequently, as to the question of notice to petitioners of the fraud complained of now in the present suit, these two interrogatories clearly disclose nothing.

(b) Before introducing the affidavits, Blades also said: "It also explains the first loan (June 6, 1925, $5,000) that the Houston Oil Company made

to Mr. Pratt, being for the purpose of buying casing to go down in one of the Pratt-Hewit wells on the Heard Tract."

Therefore, Mr. Blades, attorney for the Houston Oil Company, does not contend that the other three loans were in fact loans made in behalf of the Pratt-Hewit Corporation and his contention that the first $5,000 loan was used for such purposes is not borne out at all by the deposition of Pratt.

In Cross-Interrogatory No. 12, Pratt was asked whether he had received or borrowed money from the Houston Oil Company or the Houston Pipe Line Company. His answer was "In April, 1923 and constantly thereafter until I got it, I asked Seagraves and Moody to furnish us casing for Heard No. 2, the deep test well, and they constantly refused .... Some time the last of May, I think, I went to Houston and Galveston, at Mr. Moody's request. When in Houston, I went to see Mr. Buckner, of the Houston Oil Company, and talked with him. He said: 'I will get you the casing, Mr. Pratt,' took up the phone and inquired the price of six inch casing. I did not want to take the casing from the Houston Oil Company or Mr. Buckner, and I said to Mr. Buckner: 'If you really want to see a deep test on the Heard well, you should buy a note of the corporation due me for five thousand dollars, and in that way, if I have to buy the casing, I can pay a substantial amount on it.' Mr. Buckner took the notes and looked at them and said: 'They may be good and they may not; anyway, I will take a chance.' So Judge Kennerly drew up the note

for me to sign and attached the corporation notes for five thousand dollars as collateral." (Tr. R. 848-849)

This cannot possibly be either one of the two $5,000 loans,

(a) because they were made on June 6 and August 31, 1925, two years later than the $5,000 loan to Pratt by Buckner to which was attached a collateral $5,000 note payable to Pratt and signed by the corporation because, as Pratt testified, this was some time either in April, 1923 or the latter part of May in the same year. (Tr. R. 848)

(b) Fairbrothers testified that as to the first note of June 6, 1925, "I fail to find any record of security on that one." (Tr. R. 773) Fairbrothers made no mention of the second $5,000 note being secured, as is testified from the record, which means there was no collateral given because in reading his testimony it is clear that where collateral was given his record makes mention of it.

Fairbrothers further testified that Pratt personally paid the interest of $122.50 on the two notes on October 1, 1925, the date when the two notes were consolidated, and a new one of $10,000 given by Pratt personally. (Tr. R. 775) He also testified that with the consolidation note signed by Pratt personally of $10,000, dated October 1, 1925, there was filed a collateral note of $5,000 of the Pratt-Hewit Corporation dated October 1, 1925, due in three months, but the

record did not show to whom the collateral note was made payable. Undoubtedly, it must have been made payable to Pratt or else it would have been of no value to the Houston Oil Company.

In this deposition of Thomas H. Pratt, only one more loan is spoken of and that is on the bottom of page 852, Tr. R., and in Cross Interrogatory No. 50, propounded to Pratt, this is the question.

"Isn't it a fact that the Pratt-Hewit Oil Corporation executed a deed of trust on the 30th day of September, 1925, on all of the property of the Pratt-Hewit Oil Corporation, to the Houston Oil Company, to secure the payment of a note for $10,000.00, executed by the Pratt-Hewit Corporation, bearing interest at the rate of six per cent per annum?

Answer: Yes, it is of record and speaks for itself."

On page 854 of the Transcript of Record, Pratt testifies that Sharp, president of the Pratt-Hewit Corporation, helped him negotiate this loan with Buckner and that *the first time they spoke to the Houston Oil Company about this was on September* 26, 1925.

Certainly, it would be folly for anyone to contend that the two foregoing $10,000 notes are in fact one and the same.

That is all that Mr. Blades, the attorney for the

Houston Oil Company, offered to support his contention that the money of the first loan of $5,000 which was on June 6, 1925, or of any other loan, was used for buying casing for the Pratt-Hewit Oil Corporation and, as there was no other evidence offered by any of the other defendants at any time attempting to show that any of the money which Pratt borrowed from the Houston Oil Company was used for the purposes of the Pratt-Hewit Corporation, that leaves Blades' contention and the United States District Court's Finding of Fact No. 17, namely, "All the evidence seems to indicate that any moneys loaned at the time of or prior to September 28, 1925, were used by Thomas H. Pratt for the benefit of Pratt-Hewit Corporation in the development of that company's properties." (Tr. R. 517) without any foundation whatsoever.

Furthermore, why should the Houston Oil Company and the other defendants go to ancient documents and records to prove that some of this money which Pratt borrowed from the Houston Oil Company was in fact loans to the Pratt-Hewit Corporation, when the account books of the Houston Oil Company and the Pratt-Hewit Corporation would have answered that question beyond a doubt? During the trial of the case, the two Pratt-Hewit corporations were fighting side by side with the Houston Oil Company and were working together.

The burden of proof, as this Court said in *Pepper* v. *Lytton*, 308 U. S. 295, that the dealings of a dominant stockholder and an official of his corporation are

"subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the directors or stockholders."

However, there is another record in this case which indisputably shows that not one single dollar of the $14,500 loaned to Pratt by the Houston Oil Company was used in buying any equipment or paying any of the expenses of the Pratt-Hewit Corporation. When E. H. Buckner bought his 4/32 interest in the 200 acre lease from Pratt, Exhibit 13, Tr. R. page 940, the $18,571.40 was not paid in cash but as follows:

"(1) *The assumption by the said E. H. Buckner to pay to the Houston Oil Company of Texas the sum of Five Thousand and* no/100 *Dollars,* ($5,000.00) *upon the Note of Thomas H. Pratt to said Oil Company, bearing date, the* 1st *day of October,* 1925. Said note being for Ten Thousand and no/100 Dollars ($10,000.00) but the amount thereof assumed by the said Buckner being Five Thousand and no/100 Dollars ($5,000.000).

For the balance of the purchase price E. H. Buckner gave Thomas H. Pratt twelve installment notes, one being payable each month, bearing interest at 6%.

The attempt to torture Pratt's answer to Interrogatory No. 12 or any of his answers in his deposition as evidence that the first loan of $5,000 of June 6,

1925, or any part of any of the four loans, was used for the benefit of the Pratt-Hewit Corporation, in the light of the foregoing, is juggling with truth.

III. The Knowledge of Officials and Directors Is Not Imputed to the Stockholders.

In the brief of the Houston Oil Company et al, on page 11, it is stated: "The alleged act of fraud, the Rooke lease deal, was fully disclosed in still another State Court suit in which Pratt-Hewit Oil was a formal party by a verified pleading of Houston Oil Company filed in 1936 in the suit. " Whatever knowledge Pratt or the other directors and officers had as to the fraudulent acts of Pratt may not be imputed to plaintiffs or any other stockholders of the corporation, and also does not bind Pratt-Hewit Corporation.

> "It is, of course, well established that the officers and directors of a corporation are not the agents of the stockholders, and the stockholders are not chargeable with knowledge of the business transactions which it undertakes; that is to say, they have no duty as stockholders to inquire into the nature of the business or to influence the management, and, of course, they have no reason to suppose that the management will cause the corporation to engage in ultra vires acts. Rudd v. Robinson, 126 N.Y. 113, 26 N. E. 1046, 22 Amer. St. Rep. 816; Hughes v. Wachter, 61 N. D. 513, 238 N. W. 776; Commercial Savings Bank v. Kietges, 206 Iowa 90, 219 N. W. 44; Harrison v. Remington Paper Co. (8th Cir.)

140 F. 385." Nettles v. Childs, 100 F. (2d) 952, 957.

". . . . . Knowledge of the fraud upon the part of the directors is not knowledge on the part of the stockholders, and the fraud cannot be ratified or waived by the directors so as to bind either the corporation or the stockholders." Fletcher on Corporations, Per. Ed. Vol. 2, Sec. 548, p. 429, citing Burbank v. Dennis, 101 Cal. 90, 35 Pac. 444; Simon v. Vulcan Oil & Mining Co. 61 Pa. St. 221.

"But as a general rule, an officer whose interests are adverse cannot bind the corporation except as to innocent parties, and if he aids the third party of a fraud against the corporation, notice to him is not imputed to the corporation." Hildebrand on Texas Corporations, (published 1942) Vol. 2, p. 957 citing Greer v. Franklin Life Ins. 109 S. W. (2d) 305 and First Tex., etc. Bank v. Chapman 48 S. W. (2d) 651, 654 (Appeal Dismissed).

Respondents, Houston Oil Co. et al, in their brief, on page 10, state:

"Usury cannot be predicated upon a transaction whereby repayment of any amount under the contract rests upon a contingency of production of minerals, or upon a joint venture in which the parties pool their resources with the expectation of making a profit."

There is nothing contingent in the loans provided for in the September 28, 1925 contract, Exhibit 4, Tr.

876, in paragraphs "I," "IV," and "V," because, according to the contract, the Pratt-Hewit Corporation was obligated to repay the principal at a definite time and the interest on each loan at 6% annually. The usurious interest which consisted of a ½ interest in *all the real and personal* property of the corporation was paid immediately. The September 28, 1925 contract in itself was a sufficient immediate conveyance of an undivided ½ interest without any further written transfer.

On the 29th day of September, 1925, the very next day, the Pratt-Hewit Corporation, by written instrument, conveyed to the Houston Oil Co. an undivided ½ interest in and to said leases, which were about 23,000 acres, "together with an undivided ½ interest in and to all oil and/or gas wells on said property covered by said leases, and the equipment of every kind and character of said wells, and all personal property on said lands covered by said leases and used in connection with the development or proposed development thereon." Exhibit 6, Tr. R. 892, copied in full on page 343 of the Transcript of Record. Two leases seem to have been omitted in this conveyance and therefore on November 9, 1925, the Pratt-Hewit Corporation conveyed a ½ interest in said two leases omitted in the other conveyance to the Houston Oil Co. (Tr. R. 349).

The conveyance of the ½ interest which the Pratt-Hewit Corporation was compelled to make to the Houston Oil Co. is the part of the contract which makes the loan usurious.

The ½ interest in 23,000 acres of oil and gas leases which already had on it two producing natural gas wells, each capable of delivering into the pipe line approximately 80,000,000 cubic feet of gas a day, was sufficient proof to show that the value of the undivided ½ interest in said real and personal property made the loans highly usurious. That interest was paid when the September 28, 1925 contract was made and the subsequent conveyance was executed. There was no contingency in these transactions.

Respondents, Houston Oil Co. et al., cite the case of Pansy Oil Co., 91 S.W. (2d) 453. This case holds that a loan is not usurious where promise to pay sum above the legal rate of interest depends upon a contingency and not upon the happening of a future event. The undivided ½ interest which made the September 28, 1925 contract usurious, as we have just seen, was immediately conveyed to the Houston Oil Co. absolutely, with no condition whatsoever attached to the conveyances and the interest of 6% was made payable annually, all being secured by mortgage liens on the property of the Pratt-Hewit Corporation.

In the other case cited, *Burton* v. *Steyner*, 182 S. W. 394, the Court said:

> "It will be observed that there is no guarantee in the Aransas Pass contract that any certain profit will be made, or even that the principal will be repaid; but a method is provided whereby appellee is to be paid the capital invested and his profits before Burton and Danford get anything.

> ... ... In other words, if Burton and Danford did not make a success, he would lose his investment."

In this same case the Court also said:

> "It is true that, if the original transaction be tainted with usury, that the vice would follow the debt in whatever form it may assume. First Nat. Bank of Montague, 34 S. W. 1042."

On page 9 of their brief, respondents, the Houston Oil Co. et al, state: "When two corporations make a joint operating contract on certain land, this does not create a monopoly, etc." That assumes a conclusion to be a fact, which is disputed.

> "In Webster we find 'joint' to mean, involving the united action of two or more. 'Done or produced by two or more working together'." Barr v. Missouri Pac. R. Co. (Mo.) 37 S. W. (2d) 927, 930.

The phrase "joint operating contract" is a conclusion derived from a series of facts. The provisions of two certain paragraphs of the September 28, 1925 contract have been discussed on pages 16-24 in the petition for certiorari, and on pages 22-23 in the motion for rehearing which is the same as pages 1065-1076 of the Transcript of Record. Where the contract gives to one of the companies the exclusive right to drill wells for the production of oil and gas and where the same company, therefore, alone has the right to expend the money and do all the marketing,

and sells the gas to a subsidiary to which it is the alter ego, thus sitting on both sides of the bargain table when the price of gas is fixed, leaving nothing to the other company except the privilege of paying ½ of all the cost of production and marketing the gas and oil, that is not a joint operating company. That same assumption of a conclusion that the September 28, 1925 contract is a joint operating contract constitutes the entire argument of said respondents on the same page of the brief which is, that said contract does not violate the anti-trust laws of Texas and does not constitute an unlawful delegation of the managerial powers of the Pratt-Hewit Corporation to the directors of the Houston Oil Company.

The only case which the respondents, Houston Oil Company et al, cite in support of their contention that the September 28, 1925 contract does not violate the Anti-Trust and Monopoly Statutes of Texas and that it does not contain an unlawful delegation of the managerial powers of the Pratt-Hewit Corporation to the Houston Oil Company is the case of *Starke* v. *Guffey Petroleum*, 98 Texas, 542, on page 9 of their brief. In this case the corporation had given an oil and gas lease on the only land it had for a period of 20 years carrying a royalty of 10% of all the oil and gas produced.

The Court said that there was only one question in the case, namely, plaintiff's contention that "because the land leased was the only land owned by the company on which it could conduct its corporate business of mining, and the lease was therefore an abandon-

ment of the corporate business for which it was organized." The Court said: "The lease in question is for twenty years, and being authorized by statute, we are to consider it as legal, unless something be shown in connection with it which would invalidate it."

The case merely presented a question of whether or not the corporation had attempted to engage in a line of business for which it had not been organized. That certainly is an entirely different question than those involving violation of monopoly and anti-trust laws and unlawful delegation of powers by officials and directors of a corporation to officials of another company. The differences between these two are so clear and elemental that the case cited requires no further discussion.

In the brief of the respondents, Houston Oil Company et al, on page 2, it is stated that plaintiffs are seeking a cancellation of the September 28, 1925 contract. Among other grounds were "excessive considerations in connection with two deals made by the Houston Oil Company with Thomas H. Pratt, one involving the F. B. Rooke 200 acre lease, etc."

While in plaintiff's second amended complaint, in paragraphs 20 and 21, Transcript of Record 330, it is stated merely as a question of fact and one which has never been denied in any of the answers of any of the defendants, that the A. D. Rooke lease "was unproved oil and gas acreage and therefore of little value; that nevertheless E. H. Buckner paid to Thom-

as H. Pratt $8,000 cash for his 4/32 undivided interest and the Houston Oil Company for its 7/32 undivided interest approximately $50,000 in cash;" there is no allegation in the complaint to the effect that because the Houston Oil Company and Buckner paid an excessive price for the interest that they bought, that therefore the contract should be canceled.

In paragraph 29 of plaintiff's second amended complaint, (Tr. R. 338), it is stated that the acts of Pratt "constituted a gross abuse of trust and confidence, a sale of discretions that makes illegal and void the transactions and contracts, especially the September 28, 1925 contract out of which the fraud arose. The law also absolutely inhibits an officer or director of a corporation from placing himself in a position where his own private interests would make him neglectful of his obligations to the corporation and the stockholders."

In none of the briefs of the plaintiffs has it been contended that the contract of September 28, 1925 should be canceled because the Houston Oil Company and Buckner paid Pratt an "excessive price" for what they bought from him.

Plaintiffs have contended repeatedly in every brief that has been filed and argued before the United States District Court, as shown on pages 58 and 59 of the petition for certiorari, "The gist of this action is this, that an officer of a corporation cannot have interests that will conflict with his duties to the corporation." Yet counsel for the defendants have never

spoken one word or cited a single authority in their arguments before the Court nor discussed nor cited a case in their briefs in the way of opposing said contention that the instant that an officer of a corporation places himself in a position where self interest conflicts or may conflict with duty, the fiduciary relationship is dissolved by the act and his right to represent his corporation has ceased. Nor did the attorneys at any time even attempt to contend that what Pratt did did not conflict with the duty he owed his stockholders. A discussion of that question has been studiously avoided by the defendants' attorneys.

In reading the brief of the respondents, the Houston Oil Company et al, it was impossible not to notice that only once when Thomas H. Pratt was spoken of therein is his name given and that is on page 2. Thereafter, throughout the entire brief, or ten times in all, he is referred to simply as the "Secretary." In 1925, when the Houston Oil Company needed and in fact must have gas to supply its market requirements, Pratt was the only official of the Pratt-Hewit Corporation with whom the Houston Oil Company dealt, whom it accommodated with loans, from whom it bought an interest in the lease, the evidence of such purchase up to this date being kept secret in the company's vaults. From the organization of the company until his death Pratt was not only the secretary but the treasurer who signed all checks and the resident manager who carried on all dealings with the Houston Oil Company for the Pratt-Hewit Corporation. He also was the dominant stockholder owning considerably more than 1/3 of the stock, the

dominant official and director whose instructions the other directors implicitly followed. Yet, in respondents' brief he has dwindled to just a "Secretary."

It is pronouncedly evident that underneath this litigation there lies one fundamental question out of which all the other issues have arisen, and that is, may an officer of a corporation place himself in a position which conflicts or tends to conflict with his duty to the corporation and its stockholders without thereby having forfeited his right to represent his corporation in its dealings with the third party, the company who abetted him in betraying his cestui? Petitioners are at a loss to understand why it should be necessary to be compelled to appeal to this Court for an answer as to whether or not the collusive instruments and contracts entered into by Pratt and the Houston Oil Company present such an attempt by Pratt at serving dual conflicting interests.

The conflict of personal interest with duty is not something which happened merely in 1925 but, as we have seen, through the 3/32 leasehold interest, Pratt had a continuous monthly income paid to him by the Houston Oil Company, during all of which time he was dealing with the Houston Oil Company for his corporation. This did not end with his death. Each month, even during the time that this case was pending in the United States District and Circuit Courts and right now while it is in this Court, the income from this leasehold interest is being paid to the heirs of Thomas H. Pratt, one of whom is Laura J. Shaw,

a daughter of Thomas H. Pratt. Her husband, M. A. Shaw, shortly after the death of Thomas H. Pratt, became the president and a director of both Pratt-Hewit Corporations and still holds such positions. There is daily production from these leases and therefore daily conflict exists between Shaw's personal interest and his duty to the two corporations.

Respectfully submitted,

ARTHUR H. BARTELT
Austin, Texas

W. B. RUBIN,
Milwaukee, Wisconsin
Attorneys for Petitioners